

Insurance Regulation: Issues, Background, and Legislation in the 113th Congress

Updated January 2, 2015

Congressional Research Service

<https://crsreports.congress.gov>

R43067

Summary

The individual states have been the primary regulators of insurance since 1868. Following the 1945 McCarran-Ferguson Act, this system has operated with the explicit blessing of Congress, but has also been subject to periodic scrutiny and suggestions that the time may have come for Congress to reclaim the regulatory authority it granted to the states. In the late 1980s and early 1990s, congressional scrutiny was largely driven by the increasing complexities of the insurance business and concern over whether the states were up to the task of ensuring consumer protections, particularly insurer solvency.

Immediately prior to the recent financial crisis, congressional attention to insurance regulation focused on the inefficiencies in the state regulatory system. A major catalyst was the aftermath of the Gramm-Leach-Bliley Act of 1999 (GLBA), which overhauled the regulatory structure for banks and securities firms, but left the insurance sector largely untouched. Many larger insurers, and their trade associations, had previously defended state regulation but considered themselves at a competitive disadvantage in the post-GLBA regulatory structure. Some advocated for an optional federal charter similar to that available to banks. Various pieces of insurance regulatory reform legislation were introduced, including bills establishing a broad federal charter for insurance as well as narrower, more targeted bills.

The states, particularly working through the National Association of Insurance Commissioners (NAIC), were not idle following congressional attention. They reacted quickly to GLBA requirements that related to insurance agent licensing and have since embarked on a wider-ranging project to modernize insurance regulation. This has included both regulatory aspects, such as streamlining the process for rate and form filing, and more basic legal aspects, such as the creation of an interstate compact to provide uniformity across states for some life insurance products. Because enactment by the state legislature is necessary before the legal changes suggested by the NAIC can take effect in that state, the process typically does not move rapidly.

The recent financial crisis refocused the debate surrounding insurance regulatory reform. Unlike many financial crises in the past, insurers played a large role in this crisis. In particular, the failure of the large insurer American International Group (AIG) spotlighted sources of risk that had gone unrecognized. The need for a systemic risk regulator for the entire financial system was a common thread in many of the post-crisis financial regulatory reform proposals. The Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203), enacted following the crisis, gave enhanced systemic risk regulatory authority to the Federal Reserve and to a new Financial Services Oversight Council (FSOC), including some oversight authority over insurers. The Dodd-Frank Act also included measures affecting the states' oversight of surplus lines insurance and reinsurance and the creation of a new Federal Insurance Office (FIO) within the Treasury Department.

Among the insurance regulatory issues addressed by legislation in the 113th Congress are the application of federal orderly liquidation authority to insurers (addressed in H.R. 605); the supervision of some insurers by the Federal Reserve (addressed in H.R. 2140, H.R. 4510, H.R. 5461, S. 2102, and S. 2270/P.L. 113-279); and the licensing of insurance agents and brokers (addressed in S. 534, S. 1926, S. 2244, H.R. 1155/H.R. 1064, and H.R. 4871). In addition, various international issues may be of concern to Congress, such as the European Union's Solvency II project to overhaul the European insurance regulatory system and general international standards for insurance regulation.

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Introduction

Insurance companies constitute a major segment of the U.S. financial services industry. The industry is often separated into two parts: *life and health insurance companies*, which also often offer annuity products, and *property and casualty insurance companies*, which include most other lines of insurance, such as homeowners insurance, automobile insurance, and various commercial lines of insurance purchased by businesses. Premiums for life and health companies in 2013 totaled \$533.8 billion with assets totaling \$6.08 trillion. Premiums for property and casualty insurance companies totaled \$484.4 billion with assets totaling \$1.76 trillion.¹

Different lines of insurance present very different characteristics and risks. Life insurance typically is a longer-term proposition with contracts stretching over decades and insurance risks that are relatively well defined in actuarial tables. Property/casualty insurance typically is a shorter-term proposition with six-month or one-year contracts and greater exposure to catastrophic risks. Health insurance has evolved in a very different direction, with many insurance companies heavily involved with healthcare delivery, including negotiating contracts with physicians and hospitals, and a regulatory system much more influenced by the federal government through the Medicare, Medicaid, the Employee Retirement Income Security Act of 1974 (ERISA),² and the Patient Protection and Affordable Care Act (ACA).³ This report concentrates primarily on property/casualty and life insurance.⁴

Insurance companies, unlike banks and securities firms, have been chartered and regulated solely by the states for the past 150 years. Legal and legislative landmarks in the state-based insurance regulatory system have included Supreme Court decisions in 1868 (*Paul v. Virginia*)⁵ and 1944 (*U.S. v. South-Eastern Underwriters Association*)⁶ and federal legislation in 1945 (the McCarran-Ferguson Act).⁷ The McCarran-Ferguson Act specifically preserved the states' authority to regulate and tax insurance and also granted a federal antitrust exemption to the insurance industry for "the business of insurance." (The evolution of insurance regulation is presented in greater detail in **Appendix A**; a legal analysis of the constitutionality of federal regulation of insurance can be found **Appendix B**.)

Since the passage of McCarran-Ferguson, both Congress and the federal courts have taken actions that have somewhat expanded the reach of the federal government into the insurance sphere.⁸ The insurance industry has often been divided over the possibility of federal actions affecting insurance. The states typically, though not always, have resisted federal actions, arguing that the states are better positioned to regulate insurance and address consumer complaints and that states have engaged in concerted actions to address concerns raised at the federal level. The two large

¹ Premium amounts used are net premiums written and asset amounts are admitted assets from AM Best, *Statistical Study: U.S. Property/Casualty - 2013 Financial Results*, March 24, 2014, and AM Best, *Statistical Study: U.S. Life/Health - 2013 Financial Results*, March 24, 2014.

² P.L. 93-406; 88 Stat. 829.

³ P.L. 111-148; 124 Stat. 119.

⁴ For more information on health insurance, see CRS Report RL32237, *Health Insurance: A Primer*, by Bernadette Fernandez and Namrata K. Uberoi.

⁵ *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868).

⁶ *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944).

⁷ Codified at 15 U.S.C. §1011 *et seq.*

⁸ For more information on court decisions, see CRS Report RL33683, *Courts Narrow McCarran-Ferguson Antitrust Exemption for "Business of Insurance": Viability of "State Action" Doctrine as an Alternative*, by Janice E. Rubin.

legislative overhauls of financial regulation in the past two decades, the Gramm-Leach-Bliley Act of 1999 (GLBA)⁹ and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank),¹⁰ expanded the federal role in insurance, but the states continued as the primary regulators of insurance following these acts.

GLBA removed legal barriers between securities firms, banks, and insurers, allowing these firms to coexist under a financial holding company structure. Under the act, such a holding company was overseen by an umbrella regulator—the Federal Reserve for holding companies that included bank subsidiaries or the Office of Thrift Supervision (OTS) for holding companies with thrift or savings association subsidiaries. Within a holding company, GLBA established a system of functional regulation for the bank, thrift, securities, and insurance subsidiaries. This meant that insurance company subsidiaries within a bank or thrift holding company were functionally regulated by state insurance authorities, with limited oversight by the federal regulator of the holding company. For more information on GLBA, see “The Gramm-Leach-Bliley Act” below.

The Dodd-Frank Act altered the post-GLBA regulatory structure, while leaving the basic functional regulatory paradigm largely the same. The act gave enhanced systemic risk regulatory authority to the Federal Reserve and to a new Financial Services Oversight Council (FSOC), including some oversight authority over insurers. The authority to oversee holding companies, including those with insurance subsidiaries, was consolidated in the Federal Reserve with additional capital requirements added. The Dodd-Frank Act also included measures affecting the states’ oversight of surplus lines insurance and reinsurance and the creation of a new Federal Insurance Office (FIO) within the Treasury Department.¹¹

Insurance regulatory issues before the 113th Congress included

- overseeing the implementation of, and possible amendments to, the Dodd-Frank Act, including legislation such as H.R. 605, which would remove insurers from the act’s orderly liquidation authority; H.R. 2140, H.R. 4510, H.R. 5461, S. 2102, and S. 2270, addressing the capital requirements and accounting standards to be used by the Federal Reserve in its oversight of some insurers; and S. 2726/H.R. 5388, which would exclude captive insurers from the definition of a nonadmitted insurer under the act.
- legislation that would narrowly reform the current regulatory system, such as S. 534, S. 1926, S. 2244, H.R. 1155/H.R. 1064, and H.R. 4871, which would attempt to harmonize the state regulation of insurance producer licensing, among other provisions.
- responding to international developments, such as the changes to the European Union’s regulatory scheme known as Solvency II and the development of international standards by the International Association of Insurance Supervisors (IAIS).¹²

⁹ P.L. 106-102; 113 Stat. 1338.

¹⁰ P.L. 111-203; 124 Stat. 1376.

¹¹ For more information on the specific insurance provisions in the Dodd-Frank Act, see CRS Report R41372, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Insurance Provisions*, by Baird Webel.

¹² While no specific legislation has been introduced, Representative Randy Neugebauer, along with 48 cosigners, requested report language regarding international insurance standards be added to the FY2015 Financial Services and General Government Appropriations bill in a letter dated May 29, 2014.

Recent insurance legislation that was not introduced in the 113th Congress includes legislation to create a federal charter and regulatory apparatus for insurance (H.R. 1880 in the 111th Congress), remove or limit the McCarran-Ferguson Act's antitrust exclusion for the general business of insurance (H.R. 1583 in the 111th Congress), and expand the Liability Risk Retention Act, or LRRRA¹³ (H.R. 2126 in the 112th Congress). Draft legislation to expand the LRRRA was, however, the subject of a May 20, 2014, House Financial Services Subcommittee hearing.¹⁴

Legislation in the 113th Congress

National Association of Registered Agents and Brokers Reform Act (S. 534, S. 1926, S. 2244, H.R. 1155/H.R. 1064, and H.R. 4871)¹⁵

The National Association of Registered Agents and Brokers Reform Act of 2013 (S. 534) was introduced in the Senate by Senator Jon Tester along with 13 cosponsors on March 12, 2013. The Senate Committee on Banking, Housing, and Urban Affairs' Subcommittee on Securities, Insurance, and Investment held a hearing on the bill on March 19, 2013.¹⁶ The full committee amended the bill and ordered it reported on June 6, 2013.

Two identical bills, H.R. 1064 and H.R. 1155, were introduced in the House by Representative Randy Neugebauer. H.R. 1155 was introduced on March 14, 2013, with 42 cosponsors and additional cosponsors added since introduction, whereas H.R. 1064 has not had additional cosponsors added since its introduction with 41 cosponsors on March 12, 2013. H.R. 1155, with an amendment closely tracking the Senate committee amendment, was considered under suspension of rules and passed on a vote of 397-6 on September 10, 2013.

The National Association of Registered Agents and Brokers Reform Act would establish a National Association of Registered Agents and Brokers (NARAB). Apparently because the 1999 Gramm-Leach-Bliley Act¹⁷ included provisions that could have created an identically named association, the current legislation is often referred to as "NARAB II."¹⁸ The NARAB II association would be a private, nonprofit corporation. Its members, required to be licensed as an insurance producer in a single state and meet other requirements, would be able to operate in any other state subject only to payment of the licensing fee in that state, rather than having to obtain a separate license in the additional states, as is often the case now. The association member would still be subject to each state's consumer protection and market conduct regulation, but individual state laws that treated out-of-state insurance producers differently from in-state producers would be preempted. The NARAB II association would be overseen by a board made up of five appointees from the insurance industry and eight from the state insurance commissioners. The

¹³ 15 U.S.C. §3901 *et seq.* See CRS Report RL32176, *The Liability Risk Retention Act: Background, Issues, and Current Legislation*, by Baird Webel.

¹⁴ U.S. Congress, House Committee on Financial Services, Subcommittee on Housing and Insurance, *Legislative Proposals to Reform Domestic Insurance Policy*, 113th Cong., 2nd sess., May 20, 2014.

¹⁵ For more information, please see CRS Report R43095, *Insurance Agent Licensing: Overview and Background on Federal NARAB Legislation*, by Baird Webel.

¹⁶ Hearing webcast and statements can be found at http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=72d49be4-ff44-4d01-862a-4654e13b2589.

¹⁷ Specifically, P.L. 106-102, Title III, Subtitle C. See the discussion below under "The Gramm-Leach-Bliley Act."

¹⁸ GLBA included the provisional creation of a NARAB to streamline state insurance producer licensing for agents and brokers. The GLBA NARAB provisions, however, were not to go into effect if a majority of the states enacted uniformity in their insurance producer licensing laws and reciprocity for nonresident producer licensing laws. The states as a whole met these GLBA requirements, but some individual states never adopted reciprocity legislation.

appointments would be made by the President, and the President could dissolve the board as a whole or suspend the implementation of any rule or action taken by the association. S. 534 and H.R. 1155 as amended are nearly identical in structure, except for slightly different language relating to background checks.

On January 29, 2014, the Senate added the text of S. 534 as amended to S. 1926, a bill addressing flood insurance, by voice vote. S. 1926 as amended passed the Senate the following day by a vote of 67-32. The House, however, did not take up S. 1926, and P.L. 113-89 addressing flood insurance was ultimately enacted on March 21, 2014, without containing any NARAB provisions.

On June 19, 2014, the House Committee on Financial Services added the text of H.R. 1155 as amended to H.R. 4871, a bill addressing terrorism risk insurance, by voice vote. H.R. 4871 as amended was ordered favorably reported the following day by a vote of 32-27.

On July 17, 2014, the Senate adopted language nearly identical to H.R. 1155 as an amendment to S. 2244, a bill addressing terrorism risk insurance, by voice vote. The change introduced was a new Section 335 that would sunset the NARAB language two years after the association approves its first member. S. 2244 as amended passed the Senate on a vote of 93-4.

On December 10, 2014, the House passed a further amended version of S. 2244, including NARAB language but not including the Section 335 sunset provisions. The bill also included a new Title III related to derivatives legislation that had not been included in the Senate passed version. The House and Senate each adjourned on December 16, 2014, without resolving the differences between the versions of S. 2244 or passing other NARAB legislation.

Insurance Consumer Protection and Solvency Act of 2013 (H.R. 605)

H.R. 605 was introduced by Representative Bill Posey. This bill has been referred to the House Committee on Financial Services and was one of the bills that was the subject of a hearing on May 20, 2014.

The Insurance Consumer Protection and Solvency Act of 2013 would amend the Dodd-Frank Act so that insurance companies would essentially no longer be subject to the resolution regime created in this law. It would strike the Federal Deposit Insurance Corporation's (FDIC's) backup authority in the case of inaction by state authorities to resolve the insurance subsidiaries of financial holding companies and also exclude insurance companies from the FDIC's assessment authority to cover the cost of FDIC resolution. See "Systemic Risk Provisions" below for more information on this resolution regime.

Claims Licensing Advancement for Interstate Matters Act (H.R. 2156)

H.R. 2156 was introduced on May 23, 2013, by Representative Stephen Fincher along with two cosponsors. It was referred to the House Committee on Financial Services. H.R. 2156 would encourage uniformity and reciprocity among states that license independent insurance claim adjusters, but would not apply to states that do not license adjusters. If, within four years of enactment, a state requiring licensure does not adopt laws providing for uniformity and reciprocity, as determined by the NAIC, H.R. 2156 would provide that any licensed adjuster from another state could operate within such a state without licensure by that state. Such out of state adjusters would still be liable to pay state fees as long as these fees were uniform regardless of the residency of the adjuster.

Insurance Capital and Accounting Standards Act of 2013 (H.R. 2140)

H.R. 2140 was introduced by Representative Gary Miller on May 23, 2013. It has been referred to the House Committee on Financial Services.

H.R. 2140 would create a presumption that insurance companies subject to Federal Reserve Board supervision¹⁹ are in compliance with the minimum capital standards set by Section 171 of the Dodd-Frank Act²⁰ if they are in compliance with applicable state capital standards. The bill would permit the Federal Reserve, on a case-by-case basis, to overcome the presumption. To successfully overturn such a presumption, the bill would require the Federal Reserve to have in place and to follow duly promulgated regulations defining the applicable procedures and standards to be followed in determining that an insurance company is not in compliance with state minimum capital standards and to have completed a cost-benefit analysis and a quantitative impact study. The bill also stipulates that governing state law continues to apply and specifies that the Federal Reserve may not require insurance companies that it regulates to comply with any accounting standards differing from those applicable under state law.

“A bill to clarify the application of certain leverage and risk-based requirements ... ” (S. 2102)

S. 2102 was introduced by Senator Susan Collins on March 10, 2014. The Senate Committee on Banking, Housing, and Urban Affairs held a hearing on the bill the following day.²¹ S. 2102 would “clarify” Section 171 of the Dodd-Frank Act, popularly known as the Collins amendment. Section 171 puts certain capital requirements on financial institutions under the oversight of the Federal Reserve. The Federal Reserve has indicated that it views this section as requiring that the same standards be applied to both banks and insurers. S. 2102 amends Section 171 to specify that the federal banking agencies are not required to include regulated insurance entities engaged in the business of insurance under the minimum capital requirements required by Section 171. S. 2102, however, would not limit the authority of the Federal Reserve to apply capital standards.

Insurance Capital Standards Clarification Act of 2014 (S. 2270/H.R. 4510/H.R. 5461)

S. 2270 was introduced by Senator Susan Collins along with four cosponsors on April 29, 2014. An amended version of the bill was agreed to on the Senate floor by unanimous consent on June 3, 2014. Upon receipt in the House, it was referred to the House Committee on Financial Services. The bill was discharged from the committee and passed on the House floor without objection on December 10, 2014. S. 2270 was signed into law (P.L. 113-279) by the President on December 18, 2014.

¹⁹ This would include insurers who are part of bank holding companies or savings and loan holding companies and insurers designated as systemically significant financial institutions by FSOC.

²⁰ Codified at 12 U.S.C. §5371.

²¹ U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Finding the Right Capital Regulations for Insurers*, 113th Cong., 2nd sess., March 11, 2014.

H.R. 4510 was introduced by Representative Gary Miller along with one cosponsor on April 29, 2014. It has been referred to the House Committee on Financial Services.

H.R. 5461 was introduced by Representative Andy Barr along with three cosponsors on September 15, 2014. Title I of the bill contains the Insurance Capital Standards Clarification Act as it was passed by the Senate, whereas Titles II, III, and IV contain other changes to the Dodd-Frank Act.²² The House passed H.R. 5461 on September 16, 2014, under suspension of the rules on a vote of 327-97.

The Insurance Capital Standards Clarification Act is similar to S. 2102. It addresses the question of whether banks and insurers are required under Section 171 to have the same capital standards applied by the Federal Reserve. The bill declares specifically that the same standards are not required under this section. In addition, the bill would prevent the Federal Reserve from requiring that an insurer files financial statements according to Generally Accepted Accounting Principles (GAAP) if the company currently files statements with state regulators solely using Statutory Accounting Principles (SAP). The amended version, which passed the Senate, adds the proviso that this provision would not limit the Federal Reserve from collecting information on an entity or group-wide basis.

Policyholder Protection Act of 2014 (H.R. 4557)

H.R. 4557 was introduced by Representative Bill Posey on May 1, 2014. The bill was the subject of a House Committee on Financial Services Subcommittee on Housing and Insurance hearing on May 20, 2014. H.R. 4557 would amend the Federal Deposit Insurance Act²³ to declare that any regulation, order, or other action of the Board of Governors of the Federal Reserve System requiring a bank holding company to provide funds or other assets to a subsidiary depository institution shall not be effective nor enforceable with respect to an entity that is a savings and loan holding company that is also an insurance company, an affiliate of an insured depository institution that is an insurance company, or any other company that is an insurance company and that directly or indirectly controls an insured depository institution if (1) such funds or assets are to be provided by the entity and (2) the state insurance authority for the insurance company determines that such an action would have a materially adverse effect on the entity's financial condition.

Servicemembers Insurance Relief Act (H.R. 4669)

H.R. 4669 was introduced by Representative Edward Royce on May 19, 2014. The bill would preempt state or local laws that would require members of the U.S. military, their spouses, or their dependents to change their auto insurance policies when they have temporarily moved to comply with any temporary duty or permanent change of station order. It has been referred to the House Committee on Financial Services.

²² Title II addresses collateralized loan obligations; for more information see CRS Report IF00022, *Collateralized Loan Obligations (CLOs), Structure, Use, and Implementation of the Volcker Rule (In Focus)*, by Edward V. Murphy. Title III addresses the definition of points and fees in mortgage transactions, for more information see CRS Report R43081, *The Ability-to-Repay Rule: Possible Effects of the Qualified Mortgage Definition on Credit Availability and Other Selected Issues*, by Sean M. Hoskins. Title IV addresses margin requirements and derivatives; for more information see CRS Report R43117, *The Commodity Futures Trading Commission: Background and Current Issues*, by Rena S. Miller.

²³ 12 U.S.C. §18310-1.

Captive Insurers Clarification Act (S. 2726/H.R. 5388)

S. 2726 and H.R. 5388 were introduced on July 31, 2014, by Senator Patrick Leahy and Representative Peter Welch, respectively. The bill was referred to the Senate Committee on Banking, Housing, and Urban Affairs and jointly to the House Committee on Financial Services and the House Committee on the Judiciary. S. 2726/H.R. 5388 would amend the Dodd-Frank Act title on nonadmitted insurers to exclude captive insurers from the definition of a nonadmitted insurer.

Implementation of the Dodd-Frank Act

Federal Insurance Office

Title V, Subtitle A of the Dodd-Frank Act creates a Federal Insurance Office (FIO) headed by a director inside of the Department of the Treasury. FIO is to monitor all aspects of the insurance industry and coordinate and develop policy relating to international agreements. It has the authority to preempt state laws and regulations when these conflict with international agreements. This preemption authority is limited, applying only when the state measure (1) results in less favorable treatment of a non-U.S. insurer compared with a U.S. insurer, and (2) is inconsistent with a written international agreement regarding prudential measures. Such an agreement must achieve a level of consumer protection that is “substantially equivalent”²⁴ to the level afforded under state law. FIO preemption authority does not extend to state measures governing rates, premiums, underwriting, or sales practices, nor does it apply to state coverage requirements or state antitrust laws. FIO preemption decisions are also subject to *de novo* judicial review under the Administrative Procedure Act.²⁵ The monitoring function of FIO includes information gathering from both public and private sources. This is backed by subpoena power if the director issues a written finding that the information being sought is necessary and that the office has coordinated with other state or federal regulators that may have the information. In the 112th Congress, H.R. 3559, which would have limited this subpoena power, was marked up by the House Financial Services Subcommittee on Housing and Insurance but was not acted on by the full committee. In the 113th Congress, a draft of this bill was the subject of a subcommittee hearing.²⁶

Since the passage of the Dodd-Frank Act, the FIO has hired staff and appointed a director, Michael McRaith, a former Illinois insurance commissioner. The office has been active in international discussions with Director McRaith chosen to head a technical committee of the International Association of Insurance Supervisors (IAIS). The process of starting FIO, however, took longer than some hoped. Mr. McRaith did not take up the position of director until June 2011, nearly a year after the enactment of Dodd-Frank. FIO has released reports called for in Dodd-Frank, including an annual report and a report on regulatory modernization, but was criticized by several Members of Congress in a February 4, 2014, hearing²⁷ for missing statutory reporting deadlines.

²⁴ 31 U.S.C. §313(r)(2) as added by P.L. 111-203 §502; the law renumbers the current 31 U.S.C. §313 as 31 U.S.C. §312.

²⁵ 5 U.S.C. §551 *et seq.*

²⁶ U.S. Congress, House Committee on Financial Services, Subcommittee on Housing and Insurance, *Legislative Proposals to Reform Domestic Insurance Policy*, 113th Cong., 2nd sess., May 20, 2014.

²⁷ U.S. Congress, House Committee on Financial Services, Subcommittee on Housing and Insurance, *The Federal Insurance Office's Report on Modernizing Insurance Regulation*, 113th Cong., 2nd sess., February 4, 2014.

Systemic Risk Provisions

The Dodd-Frank Act provides for systemic risk provisions that potentially affect the insurance industry through enhanced Federal Reserve oversight and higher prudential standards for all banks with greater than \$50 billion in assets, as well as any other firms deemed systemically important financial institutions (SIFIs), and through financial resolution authority to be undertaken by the FDIC. Designation of SIFIs is to be done by the Financial Stability Oversight Council. FSOC is “charged with identifying risks to the financial stability of the United States; promoting market discipline; and responding to emerging risks to the stability of the United States’ financial system.”²⁸ It includes a presidential appointee who is to be familiar with insurance issues, a state insurance commissioner, and the FIO director, with the latter two being non-voting members.²⁹

The higher prudential standards may be set by the Federal Reserve based on various risk-related factors. The statutory standards include risk-based capital requirements that account for off-balance-sheet activities, leverage limits, liquidity requirements, risk management requirements, and exposure limits of 25% of a company’s capital per counterparty. Other prudential standards may be applied at the Federal Reserve’s discretion. The firms are required to submit resolution plans (“living wills”) and credit exposure reports. Regulated subsidiaries continue to be regulated by their primary functional regulator, although the functional regulator may be overridden if the Federal Reserve believes the firm is not adhering to regulatory standards or poses a threat to financial stability. The Federal Reserve must conduct annual stress tests on systemically significant firms and, in consultation with the FSOC and the FDIC, issue regulations establishing remediation measures to be imposed at an early stage of a firm’s “financial decline” in an effort to prevent insolvency and its potential impact on the financial system.³⁰

A financial company could be subject to the act’s special resolution regime based on a finding that its failure would cause systemic disruption. Any insurance subsidiaries of such a financial company, however, would not be subject to this regime. Instead, the resolution of insurance companies would continue to be conducted in accordance with the applicable state insurance resolution system, although the FDIC would have “backup authority” to resolve insurers if the state system has not acted within 60 days of a finding. With regard to funding for the resolution of systemically important financial firms, there is no pre-funded resolution mechanism under the act. Instead, the FDIC is to impose assessments on financial companies with more than \$50 billion in assets, as well as other financial firms that are overseen by the Federal Reserve, to fund the resolution of a systemically important firm in the event the assets of the failed firm are insufficient to do so. The FDIC is to impose such assessments on a risk-adjusted basis. When imposing such assessments on an insurance company, the FDIC is to take into account the insurers’ contributions to the state insurance resolution regimes. The FDIC has begun issuing rules regarding the new resolution regime.³¹ As detailed above, H.R. 605 would remove insurers from this resolution authority.

²⁸ See the FSOC website at <http://www.treasury.gov/initiatives/fsoc/Pages/home.aspx>.

²⁹ For more information on the FSOC, see CRS Report R42083, *Financial Stability Oversight Council: A Framework to Mitigate Systemic Risk*, by Edward V. Murphy.

³⁰ This information adapted from CRS Report R41384, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Systemic Risk and the Federal Reserve*, by Marc Labonte.

³¹ Information on the FDIC’s role in implementing Dodd-Frank can be found at <http://www.fdic.gov/regulations/reform/>.

FSOC held its first meeting on October 1, 2010, and has been issuing studies, rules, and determinations. Of particular significance to insurers was a final rule issued April 3, 2012, detailing the criteria the FSOC would use to judge nonbank financial companies systemically important and require additional oversight by the Federal Reserve.³² In general, most insurers have argued that they do not pose a systemic risk due to particular facets of insurance operations, such as the longer-term nature of risks faced by insurers, the lower likelihood of runs, and the levels of capital required by state insurance regulators.³³ Three insurers, AIG, Prudential Financial, and MetLife have been designated as SIFIs. The designation of Prudential Financial and MetLife were not without some controversy, with two members of FSOC voting against the Prudential designation³⁴ and one voting against the MetLife designation.³⁵

Federal Reserve Holding Company Oversight

The Dodd-Frank Act consolidated oversight of thrift holding companies and bank holding companies under the Federal Reserve. The act also strengthened the capital standards applied to these holding companies, particularly through Section 171, commonly known as the “Collins Amendment,” after its sponsor, Senator Susan Collins. In tandem with the Dodd-Frank requirements, the Federal Reserve is also implementing higher capital standards for banks as put forth in the Basel III agreement. Although the provisions in Dodd-Frank and Basel III do not affect the business of insurance *per se*, a number of very large insurers, including AIG and State Farm, have depository subsidiaries and now fall under Federal Reserve oversight. In addition to the capital requirements, insurers may also be affected by accounting standards required by the Federal Reserve, which differ from the standards required by state insurance regulators.

The application of Section 619 of Dodd-Frank, commonly known as the “Volcker Rule,” could also affect insurers with banking subsidiaries. This section includes restrictions on proprietary trading that potentially could constrain the investment strategies of insurers. The language, however, includes an exemption for trading done “by a regulated insurance company directly engaged in the business of insurance for the general account of the company by any affiliate of such regulated insurance company, provided that such activities by any affiliate are solely for the general account of the regulated insurance company.”³⁶ The transactions must also comply with applicable law, regulation, or guidance. There must be no determination by the regulators that a relevant law, regulation, or guidance is insufficient to protect the safety and soundness of the banking entity or the financial stability of the United States.³⁷ The FSOC released a study on the Volcker Rule required by Dodd-Frank, which includes a discussion of the insurance company exemption with a particular recommendation that “the appropriate Agencies should carefully

³² Text of the final rule can be found on the FSOC website at <http://www.treasury.gov/initiatives/fsoc/Documents/Nonbank%20Designations%20-%20Final%20Rule%20and%20Guidance.pdf>.

³³ See, for example, comments submitted on the FSOC rule by the American Council of Life Insurers and the Property and Casualty Insurers Coalition, available at <http://www.regulations.gov/#!documentDetail;D=FSOC-2011-0001-0024> and <http://www.regulations.gov/#!documentDetail;D=FSOC-2011-0001-0023>.

³⁴ Financial Stability Oversight Council, *Meeting Minutes*, September 19, 2013, available at <http://www.treasury.gov/initiatives/fsoc/council-meetings/Pages/meeting-minutes.aspx>.

³⁵ Meeting minutes

³⁶ P.L. 111-203 §619(d)(1)(F).

³⁷ This description is from CRS Report R41298, *The “Volcker Rule”: Proposals to Limit “Speculative” Proprietary Trading by Banks*, by David H. Carpenter and M. Maureen Murphy; please see this report and CRS Report R43440, *The Volcker Rule: A Legal Analysis*, by David H. Carpenter and M. Maureen Murphy for additional information.

monitor fund flows between banking entities and insurance companies, to guard against ‘gaming’ the Volcker Rule.”³⁸ The final Volcker Rule was published on December 13, 2013.³⁹

Federal Reserve officials have indicated the recognition that insurers have a different composition of assets and liabilities than banks and that Federal Reserve oversight of insurers needs to account for this. Insurers, however, have expressed concern that capital rules proposed by the Federal Reserve do not take account of particular characteristics of the industry and describe the rules as “bank-centric.”⁴⁰ Several insurers who have operated under bank or thrift holding companies have sought to divest their depository subsidiaries to avoid Federal Reserve oversight and the resulting application of the various rules put forth in Dodd-Frank and Basel III.⁴¹ MetLife is the largest firm to divest its depository subsidiary, although such steps would not prevent the FSOC from designating an insurer as systemically important and thus subject to Federal Reserve oversight from this perspective. The FSOC designated MetLife as systemically important on December 18, 2014.

Surplus Lines and Reinsurance

Title V, Subtitle B of the Dodd-Frank Act, entitled the Nonadmitted and Reinsurance Reform Act (NRRRA), addresses a relatively narrow set of insurance regulatory issues pre-dating the financial crisis. In the area of nonadmitted (or “surplus lines”) insurance, the act harmonizes, and in some cases reduces, regulation and taxation of this insurance by vesting the “home state” of the insured with the sole authority to regulate and to collect the taxes on a surplus lines transaction. The taxes collected may be distributed according to a future interstate compact or agreement, but absent such an agreement their distribution would be within the authority of the home state. It also preempts any state laws on surplus lines eligibility that conflict with the National Association of Insurance Commissioners model law unless the states include alternative uniform requirements as part of an agreement on taxes and implement “streamlined” federal standards allowing a commercial purchaser to access surplus lines insurance. For reinsurance transactions, it vests the home state of the insurer purchasing the reinsurance with the authority over the transaction while vesting the home state of the reinsurer with the sole authority to regulate the solvency of the reinsurer.

NAIC and the National Conference of Insurance Legislators (NCOIL) both developed interstate agreements that would supersede the federal provisions on tax distribution. The two models that were developed, however, differed significantly as to the extent of authority that would be ceded by the states to the new body overseeing the agreement. NCOIL’s Surplus Lines Insurance Multistate Compliance Compact (SLIMPACT) is a broader agreement that would address surplus

³⁸ Financial Stability Oversight Council, *Study & Recommendations On Prohibitions On Proprietary Trading & Certain Relationships With Hedge Funds & Private Equity Funds*, January 2011, pp. 71-75.

³⁹ *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, 79 Fed. Reg. 5,535 (January 31, 2014), available at <http://www.gpo.gov/fdsys/pkg/FR-2014-01-31/pdf/2013-31511.pdf>. The regulations were issued in a coordinated fashion, rather than issued jointly. As a result, there currently are some minor differences in the regulations issued by each federal regulator, and other differences may be implemented overtime. For example, the Commodity Futures Trading Commission (CFTC) issued “substantively similar” regulations separately from the other financial regulators. 79 Fed. Reg. 5,808 (January 31, 2014), available at <http://www.gpo.gov/fdsys/pkg/FR-2014-01-31/pdf/2013-31476.pdf>.

⁴⁰ Comments can be found at http://www.federalreserve.gov/apps/foia/ViewComments.aspx?doc_id=R-1442&doc_ver=1, see, for example, page 25 of the State Farm comment letter at http://www.federalreserve.gov/SECRS/2012/October/20121025/R-1442/R-1442_101912_109851_308150202515_1.pdf.

⁴¹ See, for example, SNL Financial, “Another insurer-owned bank seeks Shelter from oncoming regulatory storm,” November 6, 2012, available at <http://www.snl.com/InteractiveX/article.aspx?CDID=A-16216891-11568&KPLT=2>.

lines regulatory issues and taxes, whereas the NAIC's Nonadmitted Insurance Multi-State Agreement (NIMA) is more narrowly focused on tax allocation. Each approach has been ratified by some states, but most states have ratified neither. This lack of uniformity was addressed in congressional hearings, and representatives of the NAIC and NCOIL particularly pledged to address the issue, possibly through some sort of blending of the two approaches, before the House Financial Services Committee in 2011.⁴² It is unclear that significant uniformity has been achieved since this hearing, with relatively few states joining either SLIMPACT or NIMA. In the absence of some form of agreement between states, the federal requirement for home state regulation and taxation remains in effect. A 2012 report on U.S. surplus lines insurance by the insurance rating agency A.M. Best concluded that the "overall impression is that NRAA is helping lessen the paperwork load, but intermediaries wish for more consistency between the states."⁴³

International Issues

Although financial services is not an industry that produces a tangible good to be shipped across borders, the trade in such services makes up a large segment of international trade. The United States has generally experienced a surplus in trade in financial services, other than insurance, but in insurance services the United States has consistently run a deficit with the rest of the world.⁴⁴ Consolidations in the insurance industry are creating larger international entities with growing market shares, particularly in the reinsurance market. Some have speculated that the growing "internationalization" of the financial services industry means governments may find it difficult to reform their regulation in isolation. The need for a single voice at the federal level to represent U.S. insurance interests on the international stage is a frequently heard argument for increased federal involvement in insurance regulation. The FIO is specifically tasked with developing federal policy in international insurance matters.

International Regulatory Efforts

The International Association of Insurance Supervisors (IAIS) is an international organization made up primarily of insurance regulators from around the world. Its mission is "to promote effective and globally consistent supervision of the insurance industry,"⁴⁵ including international standard setting and a variety of guidances and educational efforts. Any standards set by the IAIS would not take full effect until adoption by the sovereign entities with actual authority for regulating insurance. Thus, in some ways, the role of the IAIS could be seen as analogous to that of the NAIC within the United States.

In the aftermath of the financial crisis, the IAIS is coordinating with the Financial Stability Board to identify and suggest policy measures to address global systemically important insurers (G-SIIs)

⁴² See U.S. Congress, House Committee on Financial Services, Subcommittee on Insurance, Housing and Community Opportunity, *Insurance Oversight: Policy Implications for U.S. Consumers, Businesses and Jobs*, 112th Cong., 1st sess., July 28, 2011, particularly the statements by Mr. Clay Jackson and Ms. Letha E. Heaton, available at <http://financialservices.house.gov/Calendar/EventSingle.aspx?EventID=252895>.

⁴³ A.M. Best, "2012 Special Report: U.S. Surplus Lines – Market Review. Domestic Surplus Lines Insurers Reverse Downward Trend," October 1, 2012, p. 32.

⁴⁴ In 2011, U.S. exports of non-insurance financial services were \$74.1 billion in 2011 versus imports of \$16.2 billion compared with insurance exports that totaled \$15.5 billion versus imports of \$56.6 billion. See the Bureau of Economic Analysis website at <http://www.bea.gov/iTable/iTable.cfm?ReqID=6&step=1>, Table 3a.

⁴⁵ From the IAIS website at <http://www.iaisweb.org/About-the-IAIS-28>.

and to develop a “Common Framework” (ComFrame) of capital standards for internationally active insurance groups (IAIG). Both the international standard setting by the IAIS and the G-SII designation process have raised concerns in Congress, particularly with regard to the effect these efforts might have on the competitiveness of U.S. insurers and possible weakening of the U.S. regulatory system. The House Financial Services Subcommittee on Housing and Insurance held two hearings in the 113th Congress on international issues in insurance.⁴⁶

The European Union and Solvency II

The European Union (EU), the United States’ biggest trading partner in insurance services, is implementing a comprehensive program to transform the EU into a single market for financial services. Part of this is an updated solvency regime for insurers—known as Solvency II—attempting to more closely match the capital required by regulators to the risks undertaken by insurers. It is

an ambitious proposal that will completely overhaul the way we ensure the financial soundness of our insurers. We are setting a world-leading standard that requires insurers to focus on managing all the risks they face and enables them to operate much more efficiently.⁴⁷

The European Parliament first passed Solvency II legislation in 2009. Implementation was originally expected in 2012, with the date then pushed to 2014. Currently, Solvency II is scheduled to be implemented in 2016.

As part of the Solvency II project, the EU created a new European Insurance and Occupational Pensions Authority (EIOPA) with the ability to develop regulations and rules that are binding at a European level, in contrast to the advisory nature of its predecessor. A more efficient regulatory system in the EU could improve the competitive standing of EU insurers compared with U.S. insurers. Concerns have also been expressed that the new EU system might effectively discriminate against U.S. insurers, particularly if state supervision of U.S. insurers is judged insufficiently equivalent to allow the same access to all EU countries that EU insurers will enjoy. EIOPA has published reports on equivalence for Switzerland, Bermuda, and Japan and recommended equivalence for these countries, but has not done so for the United States. There have been suggestions in the past that an EU regulatory change might serve as “a useful tool in international trade negotiations as it could help improve access for European reinsurers to foreign markets,” such as the United States.⁴⁸ A June 6, 2014, letter from the European Commission to FIO and the NAIC drew an explicit connection between an equivalency designation applying to the United States and the U.S. removal of capital requirements.⁴⁹

⁴⁶ U.S. Congress, House Committee on Financial Services, Subcommittee on Housing and Insurance, *The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers*, 113th Cong., 1st sess., June 13, 2013, and U.S. Congress, House Committee on Financial Services, Subcommittee on Housing and Insurance, *The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers, Part II*, 113th Cong., 2nd sess., November 18, 2014.

⁴⁷ Charlie McCreevy, European Union Internal Market and Services Commissioner, quoted in “‘Solvency II’: EU to take global lead in insurance regulation” available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1060&format=HTML&aged=0&language=EN&guiLanguage=en>. The general EU website on Solvency 2 is http://ec.europa.eu/internal_market/insurance/solvency/index_en.htm.

⁴⁸ European Commission, “Commission Proposes a Directive to Create a Real EU-Wide Market for Reinsurance,” *Internal Market: Financial Services: Insurance: Press Release*, April 21, 2004, at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/04/513&format=PDF&aged=1&language=EN&guiLanguage=en>.

⁴⁹ Letter from Jonathan Faull, Director General, Internal Market and Services, European Commission, to Michael

Reinsurance Collateral

Just as U.S. insurers see access to the EU as a significant issue under Solvency II, access to the U.S. market for insurance is also a significant issue for EU insurers. Of particular concern have been the state regulatory requirements that reinsurance issued by non-U.S. or “alien”⁵⁰ reinsurers must be backed by 100% collateral deposited in the United States. Non-U.S. reinsurers have asked state regulators to reduce this requirement to as low as 50% for insurers who meet particular criteria, pointing out, among other arguments, that U.S. reinsurers do not have any collateral requirements in many foreign countries and that the current regulations do not recognize when an alien reinsurer cedes some of the risk back to a U.S. reinsurer. In the past, the NAIC has declined to recommend a collateral reduction, citing fears of unpaid claims from non-U.S. reinsurers and an inability to collect judgments in courts overseas. In 2009, the NAIC put forth draft federal legislation to create a board with the power to enforce national standards for reinsurance collateral, including the reduction of collateral for highly rated reinsurers.⁵¹ In 2010, an NAIC Task Force approved recommendations to reduce required collateral based on the financial strength of the reinsurer involved. This proposal was adopted as a model law and regulation by the NAIC in November 2011. To take effect, however, these changes must be made to state law and regulation by the individual state legislatures and insurance regulators.

According to the NAIC, 21 states, collectively representing 60% of the primary insurance premiums in the United States, have adopted revised statutes or regulations with respect to reinsurance collateral reduction. To date, nine states have approved 34 reinsurers for a reduction in collateral requirements. The NAIC’s Reinsurance Financial Analysis Working Group has conducted peer reviews for more than 30 certifications issued thus far by various states, and has developed a process for certified reinsurers to be approved in multiple states on a streamlined basis (known as “passporting”). To receive the reduced collateral requirements, the reinsurer’s home jurisdiction must also be reviewed and listed on the NAIC List of Qualified Jurisdictions. In January 2014, the Bermuda Monetary Authority (BMA), the German Federal Financial Supervisory Authority (BaFin), the Swiss Financial Market Supervisory Authority (FINMA), and the Prudential Regulation Authority of the Bank of England (PRA) were given conditional qualification on an expedited basis, with complete reviews conducted by year-end 2014. In addition, the NAIC is conducting reviews with respect to the French Autorité de Contrôle Prudentiel et de Résolution (ACPR), the Central Bank of Ireland, and the Financial Services Agency of Japan.

State Regulatory Modernization Efforts

Following the passage of GLBA, state insurance regulators working through the NAIC embarked on a regulatory modernization program. These efforts were in response to both the mounting criticisms of state insurance regulation and the recognition of the growing convergence of financial services and financial services products. In early 2000, NAIC members signed a *Statement of Intent: The Future of Insurance Regulation*, in which they pledged “to modernize insurance regulation to meet the realities of the new financial services marketplace.” New NAIC working groups were formed addressing issues such as state privacy protections, reciprocity of

McRaith, director, Federal Insurance Office and Benjamin Nelson, chief executive officer, NAIC, June 6, 2014.

⁵⁰ In the United States, the term “foreign” insurer generally denotes an insurer that is chartered in a different state; those insurers from a different country have been called “alien” insurers.

⁵¹ The NAIC proposal can be found on their website at http://www.naic.org/committees_e_reinsurance.htm.

state producer licensing laws, promotion of “speed to market” of new insurance products, development of state-based uniform standards for policy form filings, and other proposed improvements to state rate and form filing requirements. Highlights of the post-GLBA NAIC efforts include the following:

- Certification of 47 states (as of September 2008) as reciprocal jurisdictions for producer licensing laws,⁵² thus exceeding the GLBA requirements to prevent the establishment of NARAB. As discussed above, however, insurance producer groups have continued to raise issues about licensing, and “NARAB II” legislation is being considered by Congress.
- Growth of the System for Electronic Rate and Form Filing (SERFF), intended to be a single, one-stop point of entry for insurers to file changes to rates and forms. More than 648,000 filings were made through the system in 2013, up from about 3,700 in 2001, and 49 states participate in the system.⁵³
- State approvals of the Interstate Insurance Product Regulation Compact. This compact is intended to provide increased regulatory uniformity and a single point of product filing for four insurance lines—life, annuities, disability income, and long-term care. It came into effect in May 2006.⁵⁴ Currently, 43 states⁵⁵ representing over 70% of the insurance premium volume have joined the compact.

The NAIC maintains that states are better positioned than the federal government to serve the interests of U.S. insurance consumers, emphasizing that state regulators are better suited to ensure that consumer interests are not lost in the arena of commercial competition. In 2013, according to the NAIC, the total budget for the state insurance departments was \$1.29 billion. The states handled more than 260,000 official consumer complaints and nearly 2.1 million consumer inquiries regarding their policies and their treatment by insurance companies and agents. The states collectively employed more than 11,500 employees to handle these complaints and perform the other functions of the state insurance departments.

Since the financial crisis, the NAIC has undertaken another round of regulatory changes. Three initiatives specifically identified by the NAIC are

- *Holding company oversight reform.* Historically, insurer oversight has focused on the individual legal entities and subsidiaries, but the financial crisis brought greater scrutiny on holding company and overall insurer group issues. In response, the NAIC adopted the revisions to model laws and regulations relating to holding company oversight.⁵⁶ The revisions included
“... expanded ability to evaluate any entity within an insurance holding company system; enhancements to the regulator’s rights to access books and records and compelling production of information; establishment of expectation of funding with regard to regulator

⁵² See http://www.naic.org/urtt_utlr.htm.

⁵³ See <http://www.serff.org/about.htm>.

⁵⁴ See <http://www.insurancecompact.org/about.htm>.

⁵⁵ Puerto Rico is also a member.

⁵⁶ Specifically the Insurance Holding Company System Regulatory Act (Model #440) and the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions (Model #450).

participation in supervisory colleges; and enhancements in corporate governance, such as Board of Directors and Senior Management responsibilities.”⁵⁷

To date, the NAIC reports 30 states have adopted these changes.

- *Enterprise risk management.* As part of insurer solvency oversight, emphasis both internationally and in the United States has been placed on companies themselves assessing, and reporting, the risks they are taking. This is generally accomplished through an “Own Risk and Solvency Assessment” (ORSA). An ORSA requires insurers to “issue their own assessment of their current and future risk through an internal risk self-assessment process and it will allow regulators to form an enhanced view of an insurer’s ability to withstand financial stress.”⁵⁸ In September 2012, the NAIC adopted a model law⁵⁹ that would require an annual ORSA and has produced a guidance manual on the topic. To date the NAIC reports that 18 states have passed the ORSA legislation.
- *Principle-based reserving (PBR).*⁶⁰ State requirements for life insurance reserves have remained static for decades, while insurance products themselves have increased in complexity. In response, the NAIC created, and states have begun adopting, a revised model law⁶¹ to transition life insurance reserving to a principle-based approach, from the current formulaic approach. According to the NAIC, 18 states comprising 28.0% of premiums have enacted PBR legislation. To avoid market disruption or an un-level playing field, PBR does not become operational until 42 states comprising at least 75% of the U.S. market have approved the law.

⁵⁷ See http://www.naic.org/cipr_topics/topic_group_supervision.htm.

⁵⁸ See http://www.naic.org/cipr_topics/topic_own_risk_solvency_assessment.htm.

⁵⁹ The Risk Management and Own Risk and Solvency Assessment Model Act (#505).

⁶⁰ See http://www.naic.org/cipr_topics/principle_based_reserving_pbr.htm.

⁶¹ The Standard Valuation Law (#820).

Appendix A. Evolution of Insurance Regulation

Insurance companies, unlike banks and securities firms, have been chartered and regulated solely by the states for the past 150 years. One important reason for this is an 1868 U.S. Supreme Court decision.⁶² In *Paul v. Virginia*, the Court held that the issuance of an insurance policy was not a transaction occurring in interstate commerce and thus not subject to regulation by the federal government under the Commerce Clause of the U.S. Constitution. Courts followed that precedent for the next 75 years. In a 1944 decision, *U.S. v. South-Eastern Underwriters Association*, the Court found that the federal antitrust laws were applicable to an insurance association's interstate activities in restraint of trade.⁶³ Although the 1944 Court did not specifically overrule its prior holding in *Paul*, *South-Eastern Underwriters* created significant apprehension about the continued viability of state insurance regulation and taxation of insurance premiums. By 1944, the state insurance regulatory structure was well established, and a joint effort by state regulators and insurance industry leaders to legislatively overturn the *South-Eastern Underwriters* decision led to the passage of the McCarran-Ferguson Act of 1945.⁶⁴ The act's primary purpose was to preserve the states' authority to regulate and tax insurance.⁶⁵ The act also granted a federal antitrust exemption to the insurance industry for "the business of insurance."⁶⁶

After 1945, the jurisdictional stewardship entrusted to the states under McCarran-Ferguson was reviewed by Congress on various occasions. Some narrow exceptions to the 50-state structure of insurance regulation have been enacted, such as one for some types of liability insurance in the Liability Risk Retention Act created by Congress in 1981 and amended in 1986.⁶⁷ In general, however, when proposals were made in the past⁶⁸ to transfer insurance regulatory authority to the federal government, they were successfully opposed by the states as well as by a united insurance industry. Such proposals for increased federal involvement usually spurred a series of regulatory reform efforts at the individual state level and by state groups, such as the National Association of Insurance Commissioners and the National Conference of Insurance Legislators. Such efforts were directed at correcting perceived deficiencies in state regulation and forestalling federal involvement. They were generally accompanied by pledges from state regulators to work for more uniformity and efficiency in the state regulatory process.

A major effort to transfer insurance regulatory authority to the federal government began in the mid-1980s and was spurred by the insolvencies of several large insurance companies. Former House Energy and Commerce Committee Chairman John Dingell, whose committee had jurisdiction over insurance at the time, questioned whether state regulation was up to the task of

⁶² *Paul v. Virginia*, 75 U.S. (8 Wall.) 168 (1868).

⁶³ *U.S. v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944).

⁶⁴ 15 U.S.C. §1011 *et seq.*

⁶⁵ Richard Cordero, *Exemption or Immunity from Federal Antitrust Liability Under McCarran-Ferguson* (15 U.S.C. 1011-1013) and *State Action and Noer-Pennington Doctrines for Business of Insurance and Persons Engaged in It*, 116 ALR Fed 163, 194 (1993).

⁶⁶ 15 U.S.C. §1012(b). The Supreme Court has made clear that the business of insurance does not include all business of insurers in *Group Health and Life Insurance, Co. v. Royal Drug, Co.*, 440 U.S. 205, 279 (1979). For further explanation of this distinction, see the CRS Report RL33683, *Courts Narrow McCarran-Ferguson Antitrust Exemption for "Business of Insurance": Viability of "State Action" Doctrine as an Alternative*, by Janice E. Rubin.

⁶⁷ 15 U.S.C. §3901 *et seq.* See CRS Report RL32176, *The Liability Risk Retention Act: Background, Issues, and Current Legislation*, by Baird Webel.

⁶⁸ Most such proposals prior to the 1990s focused on relatively narrow amendments to McCarran-Ferguson rather than large-scale replacement of the state regulatory system.

overseeing such a large and diversified industry. He chaired several hearings on the state regulatory structure and also proposed legislation that would have created a federal insurance regulatory agency modeled on the Securities and Exchange Commission (SEC). State insurance regulators and the insurance industry opposed this approach and worked together to implement a series of reforms at the state level and at the NAIC. Among the reforms implemented was a new state accreditation program setting baseline standards for state solvency regulation. Under the accreditation standards, to obtain and retain its accreditation, each state must have adequate statutory and administrative authority to regulate an insurer's corporate and financial affairs and the necessary resources to carry out that authority. In spite of these changes, however, another breach in the state regulatory system occurred in the late 1990s. Martin Frankel, an individual who had previously been barred from securities dealing by the SEC, slipped through the oversight of several states' insurance regulators and diverted more than \$200 million in premiums and assets from a number of small life insurance companies into overseas accounts.⁶⁹

Another state reform largely implemented in the late 1980s and early 1990s was the introduction of state insurance guaranty funds.⁷⁰ These funds, somewhat analogous in function to the Federal Deposit Insurance Corporation for banks, provide protection for insurance consumers who hold policies from failed insurance companies. If an insurance company is judged by a state insurance regulator to be insolvent and unable to fulfill its commitments, the state steps in to rehabilitate or liquidate the insurer's assets. The guaranty fund then uses the assets to pay the claims on the company, typically up to a limit of \$300,000 for property/casualty insurance⁷¹ and \$300,000 for life insurance death benefits and \$100,000 for life insurance cash value and annuities.⁷² In most states, the existing insurers in the state are assessed to make up the difference should the company's assets be unable to fund the guaranty fund payments. This after the fact assessment stands in contrast to the FDIC, which is funded by assessments on banks prior to a bank failure and which holds those assessments in a segregated fund until needed. Insurers who are assessed by guaranty funds generally are permitted to write off the assessments on future state taxes, which indirectly provide state support for the guaranty funds.

The Gramm-Leach-Bliley Act

The 1999 Gramm-Leach-Bliley Act⁷³ significantly overhauled the general financial regulatory system in the United States. Support for GLBA came largely as a result of market developments frequently referred to as "convergence." Convergence in the financial services context refers to the breakdown of distinctions separating different types of financial products and services, as well as the providers of once separate products. Drivers of such convergence include globalization, new technology, e-commerce, deregulation, market liberalization, increased competition, tighter profit margins, and the growing number of financially sophisticated consumers.

GLBA intended to repeal federal laws that were inconsistent with the way that financial services products were actually being delivered, and it removed many barriers that kept banks or securities

⁶⁹ See, for example, "17-Year Sentence Affirmed for Investor Who Looted Insurers," *New York Times*, March 24, 2006, available at <http://www.nytimes.com/2006/03/24/frankel.html?ref=martinfrankel>.

⁷⁰ For more information, see CRS Report RL32175, *Insurance Guaranty Funds*, by Baird Webel.

⁷¹ National Conference of Insurance Guaranty Funds, "Facts and Statistics," available at <http://www.ncigf.org/media-facts>.

⁷² National Organization of Life & Health Insurance Guaranty Associations, "Frequently Asked Questions," available at <http://www.nolhga.com/policyholderinfo/main.cfm/location/questions>.

⁷³ P.L. 106-102, 113 Stat. 1338.

firms from competing with, or affiliating with, insurance companies. The result was the creation of a new competitive paradigm in which insurance companies found themselves in direct competition with brokerages, mutual funds, and commercial banks. GLBA did not, however, change the basic regulatory structure for insurance or other financial products. Instead, it reaffirmed the McCarran-Ferguson Act, recognizing state insurance regulators as the “functional” regulators of insurance products and those who sell them.⁷⁴

Some insurance companies believe that in the post-GLBA environment, state regulation places them at a competitive disadvantage in the marketplace. They maintain that their non-insurer competitors in certain lines of products have federally based systems of regulation that are more efficient, while insurers remain subject to perceived inefficiencies of state insurance regulation, such as the regulation of rates and forms as well as other delays in getting their products to market. For example, life insurers with products aimed at retirement and asset accumulation must now compete with similar bank products. Banks can roll out such new products nationwide in a matter of weeks, while some insurers maintain that it can take as long as two years to obtain all of the necessary state approvals for a similar national insurance product launch. In the aftermath of GLBA, the largely united industry resistance to federal intervention in insurance changed. Many industry participants, particularly life insurers, larger property/casualty insurers, and larger insurance brokers, began supporting broad regulatory change for insurance in the form of an optional federal charter for insurance patterned after the dual chartering system for banks.⁷⁵

GLBA also addressed the issue of modernizing state laws dealing with the licensing of insurance agents and brokers and made provision for a federally backed licensing association, the National Association of Registered Agents and Brokers. NARAB would have come into existence three years after the date of GLBA’s enactment if a majority of the states failed to enact the necessary legislation for uniformity or reciprocity at the individual state level. The requisite number of states enacted this legislation within the three-year period, and thus the NARAB provisions never came into effect. The issue of insurance producer licensing reciprocity or uniformity continued, as some saw and continue to see problems in the actions taken by the individual states. Not every state has passed legislation implementing reciprocity, and some have argued that it has not always been implemented as smoothly as desired even in those states that did.⁷⁶

Insurance after the Gramm-Leach-Bliley Act

Congress passed the Gramm-Leach-Bliley Act to enhance competition among financial services providers. Though many observers expected banks, securities firms, and insurers to converge as institutions after it passed, this has not occurred as expected. In fact, the major merger between a large bank, Citibank, and a large insurer, Travelers, which partially motivated the passage of GLBA, has effectively been undone. The corporation that resulted from the merger, Citigroup, has divested itself of almost all of its insurance subsidiaries. Although large bank-insurer mergers

⁷⁴ Functional regulation would entail, for example, insurance regulators overseeing insurance products being offered by banks, while banking regulators would oversee banking products offered by insurers. Institutional regulation tends to focus on the charter of the institution; for example, banking regulators oversee all the activities of a bank even if the bank is offering insurance products.

⁷⁵ Banking charters are available from both the individual states and the federal government. For more information on optional federal charter legislation, see CRS Report RL34286, *Insurance Regulation: Federal Charter Legislation*, by Baird Webel.

⁷⁶ See, for example, the April 16, 2008, testimony by Tom Minkler on behalf of the Independent Insurance Agents and Brokers made before the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises at http://www.house.gov/apps/list/hearing/financialsvcs_dem/minkler041608.pdf.

did not occur as expected, significant convergence continued. Instead of merging across sectoral lines, banks began distributing—but not “manufacturing”—insurance, and insurers began creating products that closely resembled savings or investment vehicles. Consolidation also continued within each sector, as banks merged with banks and insurers with insurers. In addition, although Congress instituted functional regulation in GLBA, regulation since has still tended to track institutional lines.⁷⁷

From the 107th through the 110th Congresses, congressional interest in insurance regulatory issues continued. A number of broad proposals for some form of federal chartering or other federal intervention in insurance regulation were put forward in both houses of Congress and by the Administration, but none were marked up or reported by the various committees of jurisdiction.⁷⁸ In the same time frame, a number of narrower bills affecting different facets of insurance regulation and regulatory requirements were also introduced in Congress, including bills addressing surplus lines⁷⁹ and reinsurance, insurance producer licensing, and expansion of the Liability Risk Retention Act beyond liability insurance.

Insurance and the Financial Crisis

As the 110th Congress approached its close, the financial crisis that began in 2007 reached panic proportions with the conservatorship of Fannie Mae and Freddie Mac, the failure of Lehman Brothers, and the government rescue of American International Group (AIG) in September 2008. This crisis overlaid a range of new issues and arguments to the previously existing debate on insurance regulatory reforms. The financial crisis grew largely from sectors of the financial industry that had previously been perceived as presenting little systemic risk, including insurers. Some saw the crisis as resulting from failures or holes in the financial regulatory structure, particularly a lack of oversight for the system as a whole and a lack of coordinated oversight for the largest actors in the system. Those holding this perspective increased the urgency in calls for overall regulatory changes, such as the implementation of increased systemic risk regulation and federal oversight of insurance, particularly larger insurance firms. The generally good performance of insurers in the crisis, however, also provided additional affirmation to those seeking to retain the state-based insurance system.

Although insurers in general are considered to have weathered the financial crisis reasonably well, the insurance industry saw two notable failures—one general and one specific. The first failure was spread across the financial guarantee or monoline bond insurers. Before the crisis, there were about a dozen bond insurers in total, with four large companies dominating the business. This type of insurance originated in the 1970s to cover municipal bonds but the insurers expanded their businesses since the 1990s to include significant amounts of mortgage-backed securities. In late 2007 and early 2008, strains began to appear due to this exposure to mortgage-backed securities. Ultimately some bond insurers failed and others saw their previously triple-A

⁷⁷ See CRS Report RS21827, *Insurance Regulation After the Gramm-Leach-Bliley Act*, by Carolyn Cobb.

⁷⁸ Broad proposals from the 107th to 110th Congresses included the National Insurance Act of 2007 (S. 40 and H.R. 3200, 110th Congress); the National Insurance Act of 2006 (S. 2509 and H.R. 6225, 109th Congress); the Insurance Consumer Protection Act of 2003 (S. 1373, 108th Congress); and the Insurance Industry Modernization and Consumer Protection Act (H.R. 3766, 107th Congress), and the 2008 *Blueprint for a Modernized Financial Regulatory Structure* released by the U.S. Treasury and available at <http://www.treasury.gov/press-center/press-releases/Documents/Blueprint.pdf>.

⁷⁹ Surplus lines insurance is insurance sold by insurance companies not licensed in the particular state where it is sold. For background on this insurance, see CRS Report RS22506, *Surplus Lines Insurance: Background and Current Legislation*, by Baird Webel.

ratings cut significantly. These downgrades rippled throughout the municipal bond markets, causing unexpected difficulties for both individual investors and municipalities who might have thought they were relatively insulated from problems stemming from rising mortgage defaults.

The second failure in the insurance industry was that of a specific company, American International Group.⁸⁰ AIG had been a global giant of the industry, but it essentially failed in mid-September 2008. To prevent bankruptcy in September and October 2008, AIG sought more than \$100 billion in assistance from the Federal Reserve, which received both interest payments and warrants for 79.9% of the equity in the company in return. Multiple restructurings of the assistance followed, including nearly \$70 billion through the U.S. Treasury's Troubled Asset Relief Program (TARP). The rescue ultimately resulted in the U.S. government owning 92% of the company. The assistance for AIG has ended with all the Federal Reserve assistance repaid and the sale by the U.S. Treasury of all of its equity stake in the company.

The near collapse of the bond insurers and AIG could be construed as regulatory failures. One of the responsibilities of an insurance regulator is to make sure the insurer remains solvent and is able to pay its claims. Because the states are the primary insurance regulators, some may go further and argue that these cases specifically demonstrate the need for increased federal involvement in insurance. The case of AIG, however, is a complicated one. Although AIG was primarily made up of state-chartered insurance subsidiaries, at the holding company level it was a federally regulated thrift holding company with oversight by the Office of Thrift Supervision. The immediate losses that caused AIG's failure came from both derivatives operations overseen by OTS and from securities lending operations that originated with securities from state-chartered insurance companies.

The 111th Congress responded to the financial crisis with the Dodd-Frank Wall Street Reform and Consumer Protection Act,⁸¹ which enacted broad financial regulatory reform as detailed above. Attention on insurance regulation in the 112th Congress was largely occupied with follow-up to the Dodd-Frank Act. The Dodd-Frank Act left many of the specifics up to regulatory rulemaking, and this rulemaking is still ongoing. Of particular concern was the specific approach that the Federal Reserve may take to bank or thrift holding companies who are primarily involved in insurance and the possibility of FSOC designating some insurers as systemically important and thus subject to additional oversight. Neither issue reached a resolution during the 112th Congress.

⁸⁰ See CRS Report R42953, *Government Assistance for AIG: Summary and Cost*, by Baird Webel and CRS Report R40438, *Federal Government Assistance for American International Group (AIG)*, by Baird Webel.

⁸¹ P.L. 111-203, 124 Stat. 1376. See CRS Report R41350, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Background and Summary*, coordinated by Baird Webel.

Appendix B. Constitutional Authority for Federal Regulation of the Business of Insurance⁸²

Pursuant to the Commerce Clause of the U.S. Constitution,⁸³ it is generally constitutional for the federal government to regulate the business of insurance because, according to relevant Supreme Court precedent and subsequent decisions explaining the controlling case, the business of insurance is commerce.⁸⁴ It therefore may be regulated by the federal government in a manner coextensive with Congress's constitutional authority to regulate any other economic activity with international and interstate aspects.⁸⁵

The authority of the federal government to regulate the business of insurance as interstate commerce was not always clear. The Supreme Court in *Paul v. Virginia* had previously held that “[issuing] a policy of insurance is not a transaction of interstate commerce.”⁸⁶ The case challenged the constitutionality of a Virginia law that made it more difficult for insurance companies incorporated outside of Virginia to do business within the commonwealth. The insurance industry argued that the statute violated the dormant commerce clause, a legal concept rooted in the Commerce Clause of the Constitution, which prohibits states from discriminating against “foreign” (out-of-state) corporations.⁸⁷ The Court found that the Virginia law could not violate the Commerce Clause because insurance was not commerce. In making this determination, the Court appeared to rely on a rather narrow and mechanical definition of commerce.

These contracts are not articles of commerce in any proper meaning of the word. They are not subjects of trade and barter offered in the market as something having an existence and value independent of the parties to them ... They are not commodities to be shipped or forwarded from one State to another ... They are like other personal contracts between parties which are completed by their signature and transfer of consideration. Such contracts are not inter-state transactions, though the parties may be domiciled in different States.⁸⁸

Subsequent Supreme Court decisions affirmed the holding in *Paul* that the business of insurance was not commerce, and states relied upon this interpretation as they built regulatory systems for the business of insurance.⁸⁹

Seventy-five years after *Paul*, in *United States v. South-Eastern Underwriters Associations*, the Supreme Court ruled differently, holding that the business of insurance is, in fact, commerce and

⁸² This appendix authored by CRS Legislative Attorney Kathleen Ruane.

⁸³ U.S. Const., Art. I, §8, cl. 3. (“The Congress shall have Power ... To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.”). For a general discussion of Congress’s Commerce Clause Powers, see CRS Report RL32844, *The Power to Regulate Commerce: Limits on Congressional Power*, by Kenneth R. Thomas.

⁸⁴ *United States v. South-Eastern Underwriters Assoc.*, 322 U.S. 533 (1944).

⁸⁵ *Id.*

⁸⁶ 75 U.S. 168, 183 (1869).

⁸⁷ *Okla. Tax Comm’n v. Jefferson Lines*, 514 U.S. 175, 180 (1995) (The dormant commerce clause “prevent[s] a State from retreating into economic isolation or jeopardizing the welfare of the Nation as a whole, as it would do if it were free to place burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear.”).

⁸⁸ *Paul v. Virginia*, 75 U.S. at 183.

⁸⁹ See, e.g., *Hooper v. California*, 155 U.S. 648 (1895) (“The business of insurance is not commerce.”); *New York Life Ins. Co. v. Deer Lodge County*, 231 U.S. 495 (1913) (“Contracts of insurance are not commerce.”).

its interstate characteristics may be subject to federal regulation.⁹⁰ The case, while not explicitly overruling *Paul v. Virginia*, abrogated the *Paul* decision considerably.⁹¹ *South-Eastern Underwriters* presented the Supreme Court squarely with the question of whether Congress had the power to directly regulate the insurance industry for the first time.⁹² In the case, the Department of Justice had brought suit against certain insurance companies for violations of the Sherman Antitrust Act. The insurance companies that were accused of violating the antitrust laws argued that because the business of insurance was not interstate commerce, the Sherman Antitrust Act did not apply to the activities of the companies.

In deciding that the business of insurance is commerce and that it is also *interstate* commerce to which the federal antitrust laws did apply, the majority of the Court took a more practical and less mechanical view of commerce, generally, and the insurance industry, in particular, than the Court in *Paul*. The *South-Eastern Underwriters* Court began by describing the enormity of the insurance business as a portion of the U.S. economy and noted that many insurance companies operated out of the northeastern region of the country, but did business in multiple states, lending credence to the argument that insurance was, indeed, an interstate commercial enterprise.⁹³ Furthermore, since the *Paul* decision, other Supreme Court cases had made clear that intangible items, such as contracts not unlike insurance contracts, are items of commerce that can be regulated by Congress.⁹⁴ While the Court was willing to concede that “a contract of insurance, considered as a thing apart from negotiation and execution, does not itself constitute *interstate* commerce,” the Court found, nonetheless, that “a nationwide business is not deprived of its interstate character merely because it is built upon sales contracts which are local in nature. Were the rule otherwise, few businesses could be said to be engaged in interstate commerce.”⁹⁵

The Court concluded its analysis of the Commerce Clause question with a strong endorsement of a broad reading of the powers of Congress to regulate the business of insurance as interstate commerce. “No commercial enterprise of any kind which conducts its activities across state lines has been held to be wholly beyond the regulatory power of Congress under the Commerce Clause. We cannot make an exception of the business of insurance.”⁹⁶

Shortly after the decision was issued in *South-Eastern Underwriters*, Congress passed the McCarran Ferguson Act⁹⁷ as a direct response to that decision. The first section of the act explicitly declares it to be the policy of the United States “that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence

⁹⁰ 322 U.S. 533 (1944).

⁹¹ It appears that *South-Eastern Underwriters* did not explicitly overrule *Paul v. Virginia* because *Paul v. Virginia* presented a question regarding the limits of state authority under the commerce clause; whereas *South-Eastern Underwriters* presented a question regarding the authority of Congress to regulate the business of insurance as interstate commerce. 322 U.S. at 544.

⁹² *Id.*

⁹³ *Id.* at 539-543.

⁹⁴ *Id.* at 546.

⁹⁵ *Id.* at 547.

⁹⁶ *Id.* at 553. It is worth noting that the decision in *South-Eastern Underwriters* was not a unanimous one. The case was decided 4-3. However, two of the dissenting Justices in the case explicitly agreed with the majority that Congress could regulate the insurance industry to the same extent that it could regulate other industries in interstate commerce. *Id.* at 562-63 (J. Stone, dissenting); *Id.* at 583 (J. Frankfurter, dissenting). Justices Frankfurter and Stone dissented from the majority because they found that the Sherman Antitrust Act, the law that the companies were accused of violating, was not intended to be applied to the insurance industry.

⁹⁷ Codified at 15 U.S.C. §1011 *et seq.*

on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.”⁹⁸ The act goes on to ensure state regulatory authority over the business of insurance by preventing federal preemption of state insurance regulations, with some notable exceptions. Specifically, McCarran-Ferguson says that “[no] act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, *unless such Act specifically relates to the business of insurance.*”⁹⁹

Based upon the emphasized language, it appears that, even within McCarran-Ferguson, Congress has reserved for itself the right to directly regulate the business of insurance when appropriate. And the Supreme Court has upheld Congress’s authority to do so. For example, in *Barnett Bank of Marion County v. Nelson*, the Supreme Court held that a federal law granting national banks the ability to sell insurance preempted a Florida statute that forbid banks from selling insurance.¹⁰⁰ The Court reviewed whether McCarran-Ferguson prevented the Florida statute from being superseded by the federal law, and found that because the federal law specifically related to the business of insurance, McCarran-Ferguson’s provision preventing state insurance law preemption by federal statute did not apply. In this way, the Supreme Court upheld a federal regulation of the business of insurance, affirming that the business of insurance is commerce under the Constitution, and its interstate aspects may be regulated by Congress.

Congress’s authority to regulate the business of insurance under the Commerce Clause extends only so far as Congress’s authority to regulate interstate commerce. In the Patient Protection and Affordable Care Act,¹⁰¹ Congress enacted a requirement for all U.S. citizens to purchase health insurance, commonly known as the “individual mandate.”¹⁰² The requirement was challenged by a number of states as an unconstitutional exercise of Congress’s powers to regulate interstate commerce. The Supreme Court agreed that the individual mandate was not a valid exercise of Congress’s Commerce Clause power in a 2011 decision.¹⁰³ In his controlling opinion, Chief Justice Roberts held that while the Commerce Clause granted Congress broad authority to regulate economic activity, it did not grant Congress the power to compel individuals to engage in economic activity.¹⁰⁴ Therefore, though the Chief Justice found that Congress did not have the authority to impose the individual mandate under the Commerce Clause, Chief Justice Roberts ruled in this manner not because Congress does not have the power to regulate the business of insurance, but because the Commerce Clause does not grant Congress the authority to compel individuals to participate in economic activity.¹⁰⁵ While the individual mandate was ruled not to be a valid exercise of Congress’s power to regulate interstate commerce, the Chief Justice went on to uphold the individual mandate under Congress’s power to levy taxes.¹⁰⁶

⁹⁸ 15 U.S.C. §1011.

⁹⁹ 15 U.S.C. §1012 (b).

¹⁰⁰ 517 U.S. 25 (1996).

¹⁰¹ P.L. 111-148, 124 Stat. 119.

¹⁰² Codified at 26 U.S.C. §5000A.

¹⁰³ *NFIB v. Sebelius*, 132 S. Ct. 603 (2011).

¹⁰⁴ *NFIB*, 132 S. Ct. at 2586-87.

¹⁰⁵ *Id.*

¹⁰⁶ For a detailed analysis of the Court’s decision in this case, see CRS Report R42698, *NFIB v. Sebelius: Constitutionality of the Individual Mandate*, by Erika K. Lunder and Jennifer A. Staman.

Appendix C. Past Insurance Regulatory Legislation and Proposals

Unenacted Legislation in the 112th Congress

Several pieces of legislation addressing insurance regulation or regulatory requirements were introduced and not enacted in the 112th Congress, including both broad and narrow proposals. This legislation included the following:

The National Association of Registered Agents and Brokers Reform Act of 2011 (H.R. 1112)

H.R. 1112 was introduced by Representative Randy Neugebauer along with 47 cosponsors on March 16, 2011. A similar bill was introduced in the 110th and 111th Congresses and passed the House in each Congress, but was not acted upon by the Senate. H.R. 1112 was referred to the House Committee on Financial Services.

H.R. 1112 would have established a National Association of Registered Agents and Brokers (NARAB). NARAB was to be a private, nonprofit corporation, whose members, required to be licensed as an insurance producer in a single state and meet other standards, would be able to operate in any other state subject only to payment of the licensing fee in that state. The NARAB member would still be subject to each state's consumer protection and market conduct regulation, but individual state laws that treated out-of-state insurance producers differently from in-state producers would be preempted. NARAB would be overseen by a board made up of five appointees from the insurance industry and four from the state insurance commissioners. The appointments would be made by the President, and the President could dissolve the board as a whole or suspend the effectiveness of any action taken by NARAB.

NARAB dates back to the Gramm-Leach-Bliley Act of 1999,¹⁰⁷ and the new legislation is often referred to as "NARAB II." GLBA included the provisional creation of a NARAB to streamline state insurance producer licensing for agents and brokers. The GLBA NARAB provisions, however, were not to go into effect if a majority of the states enacted uniformity in their insurance producer licensing laws and reciprocity for nonresident producer licensing laws. The states met these GLBA requirements. However, some states have not implemented uniformity and reciprocity laws.

The Risk Retention Modernization Act of 2011 (H.R. 2126)

H.R. 2126 was introduced by Representative John Campbell along with Representative Peter Welch on June 3, 2011. It was referred to the House Committee on Financial Services.

This bill would have expanded the Liability Risk Retention Act¹⁰⁸ (LRRRA) federal preemption of state insurance laws, allowing risk retention groups (RRGs) to cover commercial property risks and risk purchasing groups (RPGs) to purchase coverage for commercial property risks. The bill would also have changed the enforcement mechanism for federal preemptions in the LRRRA and

¹⁰⁷ Specifically, P.L. 106-102, Title III, Subtitle C.

¹⁰⁸ 15 U.S.C. §3901 *et seq.* For more information, see CRS Report RL32176, *The Liability Risk Retention Act: Background, Issues, and Current Legislation*, by Baird Webel.

added additional federal corporate governance, disclosure, and fiduciary duty requirements for RRGs under the act.

Under existing law, the federal preemptions in the LRRRA are enforced through court action. If a risk retention group believes a state is attempting to regulate in a manner counter to the LRRRA, it can bring suit in a federal court. H.R. 2126 would have created a process under which the director of the Federal Insurance Office could issue determinations as to whether a state's regulation of a RRG or RPG is preempted by the act. In addition, the director was to study and issue reports to Congress on the states' regulation of RRGs and RPGs and the compliance with the LRRRA.

The corporate governance standards to be issued by the director of the FIO would have included requirements that (1) a majority of directors on an RRG's board be independent, (2) any audit committee be made up of independent directors, written governance standards be in place, and (3) contracts with service providers be limited to less than five years and be approved by the state insurance commissioner. Additional specific amendments to the LRRRA would have expanded the consumer disclosure required in the act and imposed a fiduciary duty on the board of directors of a risk retention group.

The Insurance Data Protection Act (H.R. 3559)

H.R. 3559 was introduced by Representative Steve Stivers on December 5, 2011. It was marked up by the Subcommittee on Insurance, Housing and Community Opportunity of the House Committee on Financial Services on December 8, 2011, and approved for consideration by the full committee on a vote of seven to five. The bill was not brought before the full committee prior to close of the 112th Congress. H.R. 3559 was also referred to the House Committee on Agriculture, which did not act on the legislation.

This bill would have removed the Federal Insurance Office's authority to issue subpoenas in its information gathering efforts and exclude insurance companies from the Office of Financial Research's subpoena authority. It also would have extended existing FIO confidentiality requirements that apply to insurance information gathered by FIO to the sharing of such data by FIO or the gathering of such data by federal financial regulators.

The Insurance Consumer Protection and Solvency Act (H.R. 6423)

H.R. 6423 was introduced by Representative Bill Posey along with Representative Judy Biggert on September 14, 2012. It was referred to the House Committee on Financial Services. Although no hearings directly on H.R. 6423 were held, the bill in draft form was discussed in a subcommittee hearing in November 2011.¹⁰⁹

H.R. 6423 would have amended Dodd-Frank so that insurance companies would essentially no longer be subject to the resolution regime created in this law. It would have struck the FDIC's backup authority to resolve insurance subsidiaries in the case of inaction by state authorities and excluded insurance companies from the FDIC's assessment authority to cover the cost of FDIC resolution.

¹⁰⁹ See U.S. Congress, House Committee on Financial Services, Subcommittee on Insurance, Housing and Community Opportunity, *Insurance Oversight and Legislative Proposals*, 112th Cong., 1st sess., November 16, 2011, <http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=268154>.

Unenacted Legislation in the 111th Congress

Several pieces of legislation addressing insurance regulation or regulatory requirements were introduced and not enacted in the 111th Congress, including both broad and narrow proposals. This legislation included the following:

The Insurance Industry Competition Act of 2009 (H.R. 1583)

Representative Peter DeFazio and five cosponsors introduced H.R. 1583 in the House on March 18, 2009. H.R. 1583 was referred to the House Judiciary Committee, House Financial Services Committee and House Energy and Commerce Committee. No hearings or markups were held on the bill.

H.R. 1583 would have abolished the current exemption from federal antitrust laws for the “business of insurance” that dates to the McCarran-Ferguson Act of 1945 and removed a prohibition on investigations of insurance companies by the Federal Trade Commission. It would not have changed the sections of the McCarran-Ferguson Act that give preeminence to state insurance regulators.

The National Insurance Consumer Protection Act (H.R. 1880)

Representatives Melissa Bean and Edward Royce introduced H.R. 1880 in the House on April 2, 2009. The bill was referred to the House Financial Services Committee, House Judiciary Committee, and House Energy and Commerce Committee. No further action was taken on the bill.

This bill would have created a federal charter for the insurance industry, including insurers, insurance agencies, and independent insurance producers. The federal insurance regulatory apparatus was to be an independent entity under the Department of the Treasury, and the federal law would have preempted most state insurance laws for nationally regulated entities. Thus, nationally licensed insurers, agencies, and producers would have been able to operate in the entire United States without fulfilling the requirements of each of the 50 states’ individual insurance laws.

H.R. 1880 also addressed the issue of systemic risk by designating another entity to serve as a systemic risk regulator for insurance. The systemic risk regulator was to have the power to compel systemically significant insurers to be chartered by the federal insurance regulator. Thus, although the bill shared some similarities with past optional federal charter legislation, and would have allowed some insurers to choose whether to obtain a federal charter, it was not purely an optional federal charter bill.

The National Association of Registered Agents and Brokers Reform Act of 2009 (H.R. 2554)

This bill was introduced by Representative David Scott along with 34 cosponsors on May 21, 2009. A similar bill was introduced in the 110th Congress, where it passed the House but was not acted upon by the Senate. H.R. 2554 passed the House on March 3, 2011, and was subsequently referred to the Senate Committee on Banking, Housing, and Urban Affairs, but was not acted upon by the Senate.

H.R. 2554 would have established a National Association of Registered Agents and Brokers (NARAB). NARAB was to be a private, nonprofit corporation, whose members, once licensed as an insurance producer in a single state, would be able to operate in any other state subject only to

payment of the licensing fee in that state. The NARAB member was still to be subject to each state's consumer protection and market conduct regulation, but individual state laws that treated out-of-state insurance producers differently than in-state producers would be preempted. NARAB would have been overseen by a board made up of five appointees from the insurance industry and four from the state insurance commissioners. The appointments were to be made by the President, and the President would have had the power to dissolve the board as a whole or suspend the effectiveness of any action taken by NARAB.

The Risk Retention Modernization Act of 2010 (H.R. 4802)

H.R. 4802 was introduced by Representative Dennis Moore (along with Representatives John Campbell and Suzanne Kosmas) on March 10, 2010. It was referred to the House Committee on Financial Services but was not acted upon further.

This bill would have expanded the federal preemption of state insurance laws, allowing risk retention groups to cover commercial property risks and risk purchasing groups to purchase coverage for commercial property risks. The bill would also have changed the enforcement mechanism for federal preemptions in the LRRA, and added additional federal corporate governance, disclosure, and fiduciary duty requirements for risk retention groups under the act.

Under existing law, the federal preemptions in the LRRA are enforced through court action. If a risk retention group believes a state is attempting to regulate in a manner counter to the LRRA, it can bring suit in a federal court. H.R. 4802 would have created a process under which the Secretary of the Treasury could issue determinations as to whether a state's regulation of a RRG or RPG is preempted by the act. In addition, the Secretary of the Treasury and the Comptroller General would have studied and issued reports to Congress on the states' regulation of RRGs and RPGs and the compliance with the LRRA. The corporate governance standards to have been put into place by the bill would have included requirements that a majority of directors on an RRG's board be independent; any audit committee be made up of independent directors; written governance standards be in place; and contracts with service providers be limited to less than five years and be approved by the state insurance commissioner. Specific amendments to the LRRA would have expanded the consumer disclosure required in the act and imposed a specific fiduciary duty on the board of directors of a risk retention group.

The Federal License for Reinsurers Act of 2010 (H.R. 6529)

Representative Dennis Moore introduced H.R. 6529 on December 16, 2010. It was referred to the House Committee on Financial Services but no hearings or markups were held on the bill. H.R. 6529 would have created a federal license for reinsurers. The licensing and regulatory authority would rest with the FIO, which was created under the Dodd-Frank Act, which would have the authority to determine that state laws were inconsistent with federal law and thus preempted.

Administration Proposals

2008 Treasury Blueprint

In March 2008, then-Secretary of the Treasury Henry Paulson released a *Blueprint for a Modernized Financial Regulatory Structure*. Although the financial crisis had begun at that time, the Treasury blueprint was not primarily a response to the crisis, but instead an attempt to create

“a more flexible, efficient and effective regulatory framework.”¹¹⁰ A wide-ranging document, the blueprint foresaw a completely revamped regulatory structure for financial services.

The 2008 Treasury model proposed a prudential regulator to oversee the solvency of individual companies, a business conduct regulator to oversee consumer protection, and a market stability regulator to oversee risks to the entire system. As an intermediate step, it made two specific recommendations on insurance regulation. First, it called for the creation of a federal insurance regulator to oversee an optional federal charter for insurers as well as federal licensing for agents and brokers. Second, recognizing that the debate over an optional federal charter was ongoing in Congress, it recommended the creation of an “Office of Insurance Oversight” in the Department of the Treasury as an interim step. This office would be charged with two primary functions: (1) dealing with international regulatory issues, including the power to preempt inconsistent state laws; and (2) collecting information on the insurance industry and advising the Secretary of the Treasury on insurance matters.

President Obama’s Financial Regulatory Reform Plan

In June 2009, the Treasury Department under Secretary Timothy Geithner released a whitepaper entitled *Financial Regulatory Reform: A New Foundation*, outlining President Obama’s plan to reform financial regulation in the United States.¹¹¹ The plan did not foresee as complete an overhaul as did the 2008 blueprint, but it would have substantially changed the financial regulatory system. Specific changes called for included explicitly introducing systemic risk oversight by the Federal Reserve, combining the Office of Comptroller of the Currency and the Office of Thrift Supervision into a single banking regulator, and creating a new Consumer Financial Protection Agency.

Although the June report stated that the Administration was open to additional changes in the insurance regulatory system, the specific regulatory changes called for in the released legislative language were focused on areas other than insurance. Most insurance products, for example, were excluded from the jurisdiction of the new federal consumer protection agency. In general, the states were to continue to have a preeminent role in insurance regulation. Insurance regulation, however, would have been specifically affected through two other aspects of the President’s plan: the regulation of large financial companies presenting systemic risk and the creation of a new Office of National Insurance within the Treasury.

Systemic risk regulation as proposed in the legislation would have been the primary responsibility of the Federal Reserve in conjunction with a new Financial Services Oversight Council made up of the heads of most of the federal financial regulators. The powers to regulate for systemic risk enumerated in the draft legislation extended to all companies in the United States engaged in financial activities. Although the draft legislation did not specifically name insurers as subject to federal systemic risk regulation, it would seem to have included them under federal jurisdiction. Companies judged to be a possible threat to global or U.S. financial stability could be designated Tier 1 Financial Holding Companies and made subject to stringent solvency standards and additional examinations. Such companies would also be subject to enhanced resolution authority rather than standard bankruptcy provisions. Although the draft language did make reference in some places to state functional regulatory agencies, it was left open exactly how the Federal Reserve as regulator of the financial holding company would interact with the state regulators of

¹¹⁰ U.S. Treasury, “Treasury Releases Blueprint for Stronger Regulatory Structure,” press release, March 31, 2008, available at <http://www.ustreas.gov/press/releases/hp896.htm>.

¹¹¹ See http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

the individual insurance subsidiaries. Whether federal regulatory deferral to state regulators would have continued under the proposed legislation seemed an unresolved question.

Although systemic risk regulation would likely apply to a relatively small number of insurers, the called-for creation of an Office of National Insurance could have had a broader impact. Unlike the similarly named office in other legislation, such as H.R. 1880 in the 111th Congress, President Obama's Office of National Insurance would not have overseen a federal insurance charter or have had direct regulatory power over insurers. Rather, this office was to operate as a broad overseer and voice for insurance at the federal level, including collecting information on insurance issues, setting federal policy on insurance, representing the United States in international insurance matters, and preempting some state laws where these laws are inconsistent with international agreements.

Author Information

Baird Webel
Specialist in Financial Economics

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